

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person To Contact:

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Date:

February 07, 2008

LEGEND

County =

Board of Education =

County Plan =

Board of Education Plan =

State =

Trust =

Trust Agreement =

State or County =

Retirement Plans

Dear _____ :

This is in reply to the letter dated September 21, 2007, and subsequent correspondence from your authorized representative, requesting various rulings by County on behalf of Trust.

FACTS

County and Board of Education are political subdivisions of State. By resolution, County has set out a policy for providing health benefits for retired County employees. By further resolution, County established the eligibility procedures and funding for County Plan. To be eligible for the health insurance subsidy for retiree health benefits in County Plan, a County employee must be a participant in a specified State or County Retirement Plan and have been an active County employee for a specified number of years immediately preceding receipt of the first monthly pension payment. To fund the benefits in County Plan, County annually determines a maximum subsidy for each type of coverage under the retirees' health plan. Retirees earn a subsidy of 4% of health insurance costs for each year of service with County up to a maximum amount. Retirees pay to County the difference between the cost of the selected coverage and the earned subsidy. County uses those amounts to pay for the health benefits.

The Board of Education has also entered into agreements to provide health and other benefits to retired teachers and other retired educational support personnel under the Board of Education Plan. Under the agreements, to be eligible for health benefits, the employee must be retired from the County public schools with a specified number of years of creditable service and be receiving retirement benefits from a State Retirement Plan. The Board of Education provides a subsidy of 5% of health insurance costs for each year of service with County public schools up to a maximum amount. Individual retirees are responsible for the remainder of the cost of their coverage and pay those amounts to the Board of Education which transfers the amounts to County to fund the coverage.

County represents that no salary reduction contributions are made by County Plan participants or Board of Education Plan participants to the Trust to fund the benefits of the Plans.

County entered into Trust Agreement to hold and invest amounts contributed by County to fund the retiree health benefits provided by County and Board of Education (all retiree health benefits, as specified in Trust Agreement). Contributions to Trust are irrevocable. The Board of Trustees is made up of nine members, including four members of the Board of Education, four County employees, and one member of the general public. This member of the general public has expertise in funding retiree health benefits, the economics of affordable retiree health care programs, or investing pension fund assets; is a resident of the County; and is not a County employee, an elected or appointed County official, or participant in any County retirement plan. The County may remove any or all of the Trustees upon thirty days' written notice to the Trustees.

The terms of Trust Agreement require the Trustees to hold, invest and reinvest Trust and apply income and principal thereof to pay benefits on behalf of eligible retired employees of County and Board of Education, their dependents and beneficiaries, and certain administrative expenses of Plans and Trust. The terms of Plans govern all matters pertaining to the eligibility, commencement, continuation and termination of any person's participation or coverage under Plans. Trustees are directed to hold Trust as one fund for investment purposes without segregation of any portion of Plans' assets unless otherwise directed by the County or clearly required by Plans.

County reserves the right to amend Trust Agreement in whole or in part from time to time, provided that no such amendment shall authorize or permit any part of Trust to be used or diverted to purposes other than for the exclusive benefit of Plans' participants, their beneficiaries and payment of the expenses of the Plans and Trust prior to the satisfaction of all liabilities. The County may terminate Trust at any time by resolution. In the event of termination, Trustees are to dispose of Trust assets in accordance with written directions of the County, subject to State and Federal regulations. Upon termination, notwithstanding anything contrary in Trust Agreement or Plans, in no event will the assets of the Trust be transferred to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Internal Revenue Code of 1986 (the Code)

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision of a state.

Under Rev. Rul. 77-261, 1977-2 C.B. 45, the income from an investment fund, established under a written declaration of trust by a state for the temporary investment of cash balances of the state and its political subdivisions, was excludable from gross income for federal income tax purposes under §115(1) of the Code. The ruling indicated that the statutory exclusion was intended to extend not to the income of a

state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under §115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health benefits to eligible retired County and Board of Education employees, and their spouse and dependents. Providing health benefits to current and former employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of §115(1) of the Code.

The income of Trust accrues to the benefit of County and Board of Education, political subdivisions of State. Trust's assets will be used only for administrative expenses and expenditures in providing health benefits to eligible Plan participants. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participants upon the dissolution of Trust satisfies an obligation County and Board of Education have assumed with respect to providing health benefits to retired employees. The benefit to the participating retired employees is incidental to the public benefit. See Rev. Rul. 90-74.

Section 301.7701-1(b) of the Procedure and Administration Regulations provides that the classification of organizations that are recognized as separate entities is determined under § 301.7701-2; § 301.7701-3 and § 301.7701-4 unless a provision of the Internal Revenue Code provides for special treatment of that organization.

Section 301.7701-4(a) of the regulations provides that, in general, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit. If an entity has both associates and a business purpose, it cannot be classified as a trust for federal income tax purposes. The beneficiaries of the trust cannot share in the discharge of the Trustee's responsibility for the protection and conservation of property and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 6012(a)(4) of the Code provides that every trust having for the taxable year any taxable income or having gross income of \$600 or over, regardless of the amount of taxable income, shall make returns with respect to income taxes under Subtitle A.

Section 7701(a)(1) and § 301.7701-4(a) define trusts for purposes of § 6012. Trust is classified as a trust under § 301.7701-4(a). Section 6012 does not require Trust to make returns of income when gross income is not \$600 or over.

Section 61(a)(1) of the Code and § 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1(a) of the regulations provides that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in § 152. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund (including a fund referred to in § 105(e)) which provides accident and health benefits directly or through insurance to one or more of his employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, § 106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under § 106. See Rev. Rul. 62-199, 1962-2 C.B. 32; Rev. Rul. 82-196, 1982-2 C.B. 53.

Section 105(a) of the Code provides that, except as otherwise provided in § 105, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(b) of the Code provides an exception to § 105(a). Section 105(b) provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by

him for the medical care (as defined in § 213(d)) of the taxpayer, his spouse, and his dependents (as defined in § 152 of the Code).

Based on the information submitted and representations made, we conclude as follows:

- (1) The income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1) of the Code. Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.
- (2) Trust is classified as a trust for federal income tax purposes under § 301.7701-4 of the regulations. Because Trust is classified as a trust, and because Trust's income is excludable from gross income under § 115(1) of the Code, Trust will not be required to file an annual income tax return under § 6012 of the Code as Trust will not have gross income of \$600 or over.
- (3) Contributions paid to Trust and payments made from Trust which are used exclusively to pay for the accident or health coverage of retired employees, their spouses and dependents (as defined in § 152) are excludable from the gross income of retired employees and their spouses and dependents under §§ 106 and 105(b) of the Code.

No opinion is expressed concerning the Federal tax consequences of Plans or Trust under any other provision of the Code other than those specifically stated herein. In particular, § 3.01(9) of Rev. Proc. 2007-3, 2007-1 I.R.B. 108 provides that the Service will not issue a ruling concerning whether a self-insured medical reimbursement plan satisfies the requirements of § 105(h) of the Code for a plan year. Accordingly, no opinion is expressed concerning whether Plans satisfy the nondiscrimination requirements of § 105(h) of the Code and § 1.105-11 of the regulations.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Harry Beker, Branch Chief
Health and Welfare Branch
Office of Associate Chief Counsel/Division
Counsel (Tax Exempt and Government Entities)